# Report of the Auditor General

# On the

# Consolidated Financial Statements Of the Province of Nova Scotia For the Year Ended March 31, 2003

# And

# Other Financial Reporting Practices

November 14, 2003

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NOVA SCOTIA

Office of the
Auditor General

104-01885/

Honourable Murray Scott
Speaker
House of Assembly

Sir:

As per my October 15, 2003 notice attached, I have the honour to submit herewith an additional report to the House of Assembly to be laid before the House in accordance with Section 9A(1) of the Auditor General Act.

This report consists of a November 12, 2003 letter issued to the President and Members of the Executive Council in regards to their oversight responsibility for government's financial reporting process.

Respectfully submitted

E. Roy Salmon, FCA
Auditor General

Halifax, Nova Scotia
November 14, 2003



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October 15, 2003

Honourable Murray Scott
Speaker
House of Assembly
Province House, 1st Floor
P.O. Box 1617
Halifax, Nova Scotia
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**RE: Notice of Additional Report**

Dear Sir:

As required under Section 9A(3) of the Auditor General Act, I wish to notify you that I am proposing to make an additional report to the House of Assembly on or after November 14, 2003. This report will deal with the results of my audit work on the government's March 31, 2003 consolidated financial statements and other financial reporting practices.

The release of this additional report will if practical be tabled (deemed tabled) concurrent with the government's release of its March 31, 2003 consolidated financial statements upon which I report separately as required under Section 9 of the Auditor General Act.

If you have any questions or wish to discuss this notification, please contact me.

Yours very truly,

(original signed by)

E. Roy Salmon, FCA
Auditor General

cc Honourable Peter Christie, Minister of Finance
Mr. Howard Windsor, Deputy Minister of Finance
Mr. Gordon Gillis, Deputy Minister, Office of the Premier

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November 12, 2003

President and Members
of the Executive Council
Province of Nova Scotia
Halifax, Nova Scotia

Dear President and Members of the Executive Council:

**Re: Audit of March 31, 2003 Financial Statements and Related Matters**

Under Section 9 of the Auditor General Act, I am mandated to audit and report on the annual financial statements of the Province. Attached to this letter as Appendix 1 on page 4 is a draft of my auditor's report dated July 15, 2003 on the Province's March 31, 2003 consolidated financial statements.

Professional standards require that the auditor of an entity with public accountability, like the Province, communicate prior to completion of a financial statement audit with those having oversight responsibility for the entity's financial reporting process. In the private sector, normally this responsibility rests with an entity's audit committee. For the Province's financial reporting, oversight responsibility rests, to a significant extent, with the Executive Council, but also to some extent with the Legislature's Public Accounts Committee.

The primary purpose of this letter is to communicate in accordance with the professional standards referred to above, including a summary of the results of my audit of the Province's March 31, 2003 consolidated financial statements. In addition, I include comments for consideration on selected other financial reporting by government.

Unless specifically agreed to, until available publicly, I request that distribution or communication of and reference to the contents of this letter (in whole or in part) be limited to those copied below.

It is my intention to include a copy of this letter in a report under Section 9A(3) of the Auditor General Act to be tabled (or deemed tabled) in the House of Assembly on or after November 14, 2003. That section requires 30 days notice to the Speaker, and such was provided in a letter dated October 15, 2003. The use of this reporting option is necessary in order to make this letter available to members of the Public Accounts Committee on a timely basis relative to the public release of the consolidated financial statements.

In considering the information to be provided in this letter, I have referred to the CICA Handbook's Section 5751 – *Communications with those having Oversight Responsibility for the Financial Reporting Process.* Attached in Appendix 2 on pages 5 to 9 of this letter are my communications on certain required matters.

## Summary Observations

***Introductory and overview comments*** – The Members of the Legislative Assembly (and the public) require financial information and reporting on the Province's financial position and results – both plans and performance – on a complete, accurate, understandable and timely basis. The adoption of generally accepted accounting principles (GAAP) as a basis of accounting in 1999 helps government meet this requirement. The use of GAAP as a basis of accounting provides an authoritative foundation or source upon which government can both choose and defend its accounting policy decisions and disclosure practices.

Nova Scotians should recognize, and have reason to be proud of, the progress that has been made in the past five years through the implementation of GAAP for purposes of the Province's annual financial statements. The implementation of GAAP for government's financial reporting, most notably its annual consolidated financial statements, has allowed Nova Scotia to move from the bottom of the pack as it relates to Canadian provincial government financial reporting, to that of a leader.

**Audited annual financial statements** – At the time this letter was issued, the Province's March 31, 2003 consolidated financial statements for the March 31, 2003 fiscal year were to be released by government on November 13, 2003, along with my auditor's report thereon, as part of the March 31, 2003 Public Accounts.

Based upon the audit procedures completed, I concluded that the March 31, 2003 consolidated financial statements, which are the responsibility of the Minister of Finance on behalf of the Government of Nova Scotia, present fairly, in all material respects, the financial position of the Province as at that date and the results of its operations, changes in net direct debt and cash flows for the year then ended in accordance with Canadian generally accepted accounting principles for the public sector.

**Other financial reporting (unaudited)** – In addition to the Province's annual financial statements, government releases other – unaudited – financial information and reports at various times. Unless indicated otherwise, readers of financial information and reports should be able to rightfully assume that the information provided by government is prepared on a consistent basis and suitably comparable. It is government's obligation to provide financial information and reports on a consistent basis, and where not consistent, provide the information required for comparability.

Since April 1, 2003, government has released formal unaudited financial information and reports that have not fully reflected GAAP requirements. While I do not and have not audited those reporting documents, the following observations are provided for future consideration.

- Government's retirement health benefits obligations and costs were not included in or disclosed with the financial projections included in the April 3, 2003 budget documents or the June 11, 2003 debt reduction plan. For example, as a result the net direct debt projections in the budget were understated by approximately $500 million.

- The impact of government's decision to switch to the smoothed market value method from fair market value for pension asset accounting was not adequately disclosed in the April 3, 2003 budget documents. As a result, the comparability of the 2003-04 Estimate and 2002-03 Forecast (both of which reflected this change in accounting policy) to the 2002-03 Estimate for the pension valuation adjustment line item was impaired.

- The September 19, 2003 Fiscal 2003-04 Forecast Update did not adequately disclose that it reflected retirement benefit accounting policy adjustments that had not been included in the April 3, 2003 budget.

- The revenue estimates included in the 2003-04 budget were, as per government's practice, prepared using official census data then available. The 2003-04 budget and the 2003-04 forecast update documents could have disclosed the scheduled release of updated census information by Statistics Canada, and the associated contingency to government's fiscal plans.

Further comments and discussions of the above are included in Appendix 3 on pages 10 to 11 of this letter.

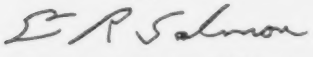
* * * * *

This letter is provided at this time solely for the information of the government's executive management. Until it is available to the Members of the House of Assembly, I respectfully request it not be used, circulated, quoted or otherwise referred to for any purpose, without my prior written consent.

The cooperation and assistance provided during this year's audit by accounting staff across government is appreciated. I would like to specifically acknowledge the contributions of Mr. Kevin Malloy, CA, Controller, Ms. Suzanne Wile, CA, Director of Government Accounting, and their staff.

In closing, if there are any questions on the results of my audit or any other matters, please contact me.

Yours truly,



E. Roy Salmon, FCA
Auditor General

cc Howard Windsor, Deputy Minister of Finance
Vicki Harnish, Deputy Minister of Treasury and Policy Board
Kevin Malloy, CA, Controller

Attachments

NOVA SCOTIA

Office of the
Auditor General

**Appendix 1**

**Draft**

## Auditor's Report

To the Members of the Legislative Assembly of Nova Scotia

I have audited the consolidated statement of financial position of the Province of Nova Scotia as at March 31, 2003 and the consolidated statements of operations, change in net direct debt and cash flow for the year then ended. These statements are the responsibility of the Government of Nova Scotia, represented by the Minister of Finance. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Province of Nova Scotia as at March 31, 2003 and the results of its operations, changes in net direct debt and cash flows for the year then ended in accordance with Canadian generally accepted accounting principles for the public sector.

E. Roy Salmon, FCA
Auditor General

Halifax, Nova Scotia
July 15, 2003

## Communications Required
## On Audit of Province's March 31, 2003
## Consolidated Financial Statements

### Responsibilities

The Province's consolidated financial statements are the responsibility of the Government, represented primarily by the Minister of Finance. This includes responsibilities related to internal control, such as the design and maintenance of accounting records, selecting and applying accounting policies, safeguarding assets, and preventing and detecting error or fraud.

My responsibility is to express an opinion on the Province's consolidated financial statements based on my audit. My audit of the consolidated financial statements is not designed to identify matters that may be of interest to government in discharging its responsibilities, and accordingly would not usually identify all such matters.

I have also read, but not audited, the information in the Financial Highlights section of Volume I of the Public Accounts. Where applicable, totals have been agreed to the consolidated financial statements upon which I have reported.

### Audit Approach

The audit of the Province's consolidated financial statements is conducted in accordance with generally accepted auditing standards. The audit is planned and performed to obtain reasonable, but not absolute, assurance whether the statements are free of material misstatements.

The audit includes assessing the risk that the consolidated financial statements may contain material misstatements; examining, on a test basis, evidence supporting the amounts and disclosures in the statements; assessing the accounting principles used and their application; and assessing significant estimates made by government. For purposes of this audit, an understanding of government's systems of internal control is obtained sufficient only to support planned coverage.

To the extent appropriate, results of other audit work performed under the mandates of the Auditor General Act or other statutory provisions are considered during the audit of the Province's consolidated financial statements. Further, the results of annual financial statement audits of the various crown entities reported upon by other auditors are reviewed and relied upon as part of my audit.

### Independence

Independence is critical to the effectiveness of any audit function. An auditor must be independent, and be perceived to be independent, of the entity and operations subject to audit. Unless there is a clear demonstration of objectivity in the work of the auditor, the



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auditor's opinions and reporting will not be fully accepted and the auditor's work will lose value.

Canadian generally accepted auditing standards (GAAS) require that I communicate annually all relationships between the Province or the government and me that, in my professional judgement, may reasonably be thought to bear on my independence. In this regard, I am not aware of any relationships between the Province or the government and me that, in my professional judgement, may reasonably be thought to impair my independence.

GAAS requires that I confirm my independence. Since the Rules of Professional Conduct of the Institute of Chartered Accountants of Nova Scotia deal with the concept of independence in terms of objectivity, my confirmation is made in that context. I confirm that I am objective with respect to the Province and the government within the meaning of the Rules of Professional Conduct of the Institute of Chartered Accountants of Nova Scotia. In this regard, provisions of the Auditor General Act reinforce and support the independence and objectivity of the Auditor General and the Office of the Auditor General.

Each year the House of Assembly approves an appropriation for the net funding of the Office of the Auditor General. In addition to the audit of the Province's consolidated financial statements, the Auditor General audits the annual financial statements of various crown entities. Audit fees recovered from these entities are included in the determination of the net funding of my Office.

In addition to the audit and other work conducted as a result of my statutory mandates under the Auditor General Act or other statutory provisions, the Office performs certain review and compilation procedures on government's annual filing with the US Security Exchange Commission. My most recent cost-recovery billing to the Department of Finance for this work was for $21,500.

Further, during the current year's audit of the consolidated financial statements, we billed the Department of Finance $4,000 for time spent by my staff preparing a supporting trail and analysis for the balances due to or from the federal government for major revenue sources that had not been prepared prior to the start of the year end audit work.

**Audit Results**

***Significant accounting policies and disclosure practices*** – As indicated in Note 1 to the March 31, 2003 consolidated financial statements, for purposes of the Province's statements, Canadian GAAP for the public sector is represented by the accounting recommendations of the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants (CICA), supplemented where appropriate by other CICA accounting standards or pronouncements.

With the retroactive implementation of the accounting changes disclosed in Note 2 to the March 31, 2003 consolidated financial statements, the government is compliant with significant current GAAP requirements.

There are some new and in process PSAB pronouncements that will likely have an impact on the government's future reporting of financial performance and financial condition. As new or updated pronouncements are issued, government will need to be prepared to implement them on a timely basis, including in its fiscal plans.

> **I recommend the government, with leadership from the Minister of Finance, monitor PSAB initiatives, as well as relevant accounting recommendations from CICA and Internationally, in order to ensure adjustments necessary to government's financial planning and reporting be implemented on a timely basis.**

***Systems and controls*** – As part of my audit, internal controls were reviewed only to the extent necessary under Canadian generally accepted auditing standards to establish a basis for determining the audit coverage necessary to express an opinion on the Province's consolidated financial statements. The audit work was not designed to determine whether internal controls are adequate for management's purposes and will not necessarily disclose all conditions requiring attention by management.

While conducting the financial statement audit, areas were identified where internal controls should be strengthened or operating improvements could be achieved. Certain matters identified during the current year have implications which warrant government's attention. These matters will be discussed with government management staff as part of post-audit review and reporting meetings, and reported upon more formally in a management letter at a later date.

Further, as it relates to the internal controls of the entities included in the Province's financial statement reporting entity, reliance has been placed on the audit work of public accounting firms appointed to report on the financial statements of those entities. As in previous years, the 2003 Report of the Auditor General will include summary information on any significant weaknesses in internal controls which were reported to those entities by their auditors.

***Management judgments and accounting estimates*** – Government's preparation of the Province's consolidated financial statements requires the use of significant accounting estimates, certain of which are particularly sensitive to the possibility that future actual information may differ from government's assumptions upon which the accounting estimates are based. For example, significant accounting estimates are used for determining accruals for income taxes, sales taxes, federal equalization and CHST transfers, restructuring costs, and net retirement benefit obligations or costs.

***Adjustments made to the financial statements*** – During the audit of the government's March 31, 2003 consolidated financial statements a number of accounting, disclosure

and audit issues arose, and were communicated to government staff at various points in the audit process. Some, but not all, of these were resolved either by review of additional information provided to my staff or by adjustments being made to the financial statements. Unresolved matters identified are discussed later in this letter, and will be more fully reported as part of a post-audit process. Certain of these items related to matters that had been reported upon in previous years as well.

***Misstatements in the financial statements*** – It is quite common for financial statements of an entity the size and nature of the Province to have residual issues at the conclusion of an audit. Such issues may be classified as "known" or "possible" depending on the support available. Any unresolved unadjusted errors or differences are considered when preparing the auditor's report on whether the statements "present fairly" in accordance with GAAP.

There were unadjusted errors or differences – known and possible – identified during the audit, but I have concluded that there were none that would, individually or collectively, materially affect the Province's reported financial position, results of operations, changes in net direct debt or cash flows. For example, the summary of unadjusted differences for my audit includes net known errors with less than a $2 million positive impact on the reported surplus.

While residual errors or differences are relevant to the audit opinion on the current year's statements, it must also be acknowledged that certain issues will also have a reversing or carry-forward effect on the statements of the subsequent year(s). There were residual issues, known possible, certain of which will be considered opening or carry-forward issues for the audit of the Province's March 31, 2004 consolidated financial statement.

***Disagreements with management*** – During this year's audit, discussions continued with Finance on the need to adjust the financial statements for known errors and misstatements. This is a matter that will require further discussion and appropriate clarification as it relates to the planning for the audit of the Province's 2004 financial statements. With regard to the Province's financial statements and government's other financial reporting, it is my opinion that all but trivial known errors or misstatements identified during the year end accounting or the audit processes should be corrected.

***Difficulties encountered performing audit*** – There were no limitations placed on the scope of the audit work carried out. While information is received on a timely basis from many departments and other crown entities (and their auditors), again this year both Finance and my Office experienced significant problems and prolonged delays obtaining requested information from certain entities.

Serious delays were encountered again this year by Finance government accounting and my Office in the performance of our respective responsibilities as a result of delays in the receipt of requested information or responses from various entities or their auditors.

**I recommend government ensure all provincial entities comply with Section 16(2) of the Provincial Finance Act that requires financial statements be available to Finance by the end of June.**

***No illegal acts*** – No acts, which were or could be illegal, came to my attention during the course of this year's audit, which your government would not already be aware of.

***Existence or suspicion of fraud*** – No irregularities came to my attention during the course of this year's audit which suggested any incidence of fraud on the part of any employee of the government, which your government would not already be aware of.

***Related party transactions*** – No related party transactions came to my attention during the course of this year's audit which were other than in the normal course of operations and which involve significant judgments by management concerning measurement or disclosure.

***Risk of undesired outcomes*** – During the audit, no unusual actions were identified which would significantly increase the risk of loss for government.

* * * * *

## Comments on Government's Other Financial Reporting Since April 1, 2003

**Disclosure of accounting policy changes** – One of the basic and fundamental attributes of comparative financial reporting is consistency. As a result, readers of financial statements and other financial reporting assume, unless indicated otherwise, that comparative information is presented on a consistent and comparable basis. Where there are differences due to non-comparability, there should be adequate disclosure of the differences both as they relate to any restatements that are made and any changes that are recorded on a prospective basis.

Since March 31, 2003, government has released formal unaudited information and reports on its fiscal plans or performance. These include:

- April 3, 2003 budget for 2003-04;
- June 11, 2003 debt reduction plan; and
- September 19, 2003 – forecast update for 2003-04

While I do not and have not audited those reporting documents, the following observations are provided for future consideration.

I acknowledge government's decision to implement in the Province's March 31, 2003 consolidated financial statements the updated Public Sector Accounting Board requirements which were released in September 2001 for the accounting and disclosure of pension and other retirement benefits. However, I am concerned about the manner in which the government failed to adequately disclose the extent to which it had (or had not) implemented accounting policy changes in its other financial information and reports released since March 31, 2003.

As previously communicated to the Minister of Finance's predecessor, I have expressed concerns about how the obligations and costs associated with retirement health benefits were not fully and adequately taken into account in the financial projections included in the budget support and the debt reduction plan.

Other than the "Pension Plan Accounting" budget bulletin, government's budget documents did not alert users to the fact that the 2003-04 Estimate and the 2002-03 Forecast amounts shown for the pension valuation adjustment line item were prepared on a different basis than that used for the 2002-03 Estimate.

In this regard, the change in accounting (i.e., using smoothed market values versus fair market values for pension asset accounting) and its impact on the comparability of the information provided should have been disclosed. Such disclosure would have allowed MLAs and other users of the budget documents to make a more informed assessment of government's fiscal plans and performance against the 2002-03 Estimate.



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It is important to note that I am not taking exception to government's decision to switch to the use of a smoothed market value method for pension asset accounting, since that was an option that had been available under GAAP for a number of years. Rather, my concern is that there should have been additional disclosure of the change and its dollar impact.

I also note that the September 19 forecast update for 2003-04 included, in the forecast column, two additional changes in pension accounting which were not included in the 2003-04 budget. Both of these changes are appropriate and required in order to adhere to generally accepted accounting principles, and in fact have been accounted for in the March 31, 2003 financial statements of the Province. The forecast update could have more adequately disclosed the changes.

**Disclosure of contingencies** – Government's 2003-04 revenue estimates were prepared using the then current official Statistics Canada census data. Information available to my Office in October 2003 on new Statistics Canada data on the 2001 census indicates that it was still subject to further significant review and challenge processes at the time the 2003-04 revenue estimates were finalized by government in March 2003.

The existence of this contingency as it relates to the 2003-04 revenue estimates and the 2002-03 revenue forecast information included in the April 3, 2003 budget documents should have been more fully disclosed as part of the reporting to the House of Assembly. Further, this matter should have been disclosed as part of the September 19, 2003 Fiscal 2003-04 Forecast Update.

I further note that this matter should have been brought fully to the attention of my staff at the conclusions of not only the 2003-04 revenue estimates review work in March 2003, but also the 2001-02 financial statement audit in December 2002. Formal management representation letters received from government at the end of those assignments make no reference to this particular matter, and in fact include confirmation that no such contingencies existed.

**I recommend that government financial information and reporting to the House of Assembly be prepared and presented in a manner consistent with generally accepted accounting principles.**

**I recommend that where comparative financial information or reporting by government is not or cannot be prepared on the same basis of accounting, supplementary information be provided on the differences and their dollar impact so that readers can appropriately consider the effects of the changes. Even if changes are applied retroactively (i.e., restatement of previously released information) appropriate information needs to be provided by way of footnote so that readers can assess the effect of the changes.**

* * * * *